To Be, Rather Than to Seem: Analysis of Trustee Fiduciary Duty in Reorganization and Its Implications on the New Chinese Bankruptcy Law

CHARLIE XIAO-CHUAN WENG*

Abstract

Reorganization trustees play a crucial role in bankruptcy procedure. The trustees try to resurrect deteriorating businesses by managing remaining resources for the benefit of beneficiaries, usually unsecured creditors, and shareholders. More or less, a trustee's role is similar to that of the officers or managers of a solvent company. Fiduciary duty arises between the residual claimers and the stakeholders on one hand, and the operator and the trustee on the other hand. Astonishingly, under current U.S. bankruptcy law, the reorganization trustee's fiduciary duty is not well defined, although this duty has been widely litigated. The vagueness is primarily due to misinterpretation of the Mosser *case, adjudicated by the U.S. Supreme Court. Fortunately, multitudes of academic literature on fiduciary duty in corporate law explain the application issues and clarify the vagueness of trustee fiduciary duty. But fiduciary duty is highly context-specific. Corporate fiduciary duty cannot be arbitrarily applied to the bankruptcy context without necessary modification.*

In China, the unclear definition of the trustee fiduciary duty has greatly dampened the efficacy of the reorganization mechanism of the new bankruptcy law. Given the pressures of the current global financial crisis, it is imperative to amend the duty so it is more viable and practical. Given that the current Chinese reorganization mechanism is transplanted from U.S. bankruptcy regulation, retrospection to its origin is helpful in improving the trustee fiduciary duty. This article also explores the use of the case directive to facilitate the adaptation and increase the flexibility of such duty in practice.

* Visiting Scholar, Yale Law School, 2011-2012, senior Research Fellow, and Associate Professor, International School of Financial Law (ISFL), East China University of Political Science and Law (ECUPL). The early version of this article was present at the plenary lecture of Law and Economics workshop at ISFL. In addition to the participants of the presentation, I would like to thank Professor David A. Skeel, Mrs. Siu Yan Chan, and Dr. Herbert Wolfe for reading an earlier draft of this paper and their invaluable comments. Also, I am indebted to Justice Ni Jiali and Lu Yin for their valuable data and wonderful insights. All errors are mine.

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I. Introduction

Reorganization[1] is a tool that permits insolvent corporations to enter into a debt restructuring process and avoids liquidation of the firm's assets.[2] The bankruptcy court oversees this process. During reorganization, a trustee may be appointed to operate and financially restructure the firm.[3] Since the restructuring process involves decisions that substantially change the rights of the various stakeholders, the trustee's actions are subject to much scrutiny.[4] Creditors and shareholders are seldom pleased with the decisions of the trustee, because the insolvent firms tend to continue to flounder.[5] Even when the trustee's business decisions are logical and well thought out, many stakeholders feel as

1. For the simplicity and continuity of this article, the author will use "reorganization" and "trustee" rather than "Chapter 11 case" and "Chapter 11 trustee" respectively. When the author mentions reorganization and trustee for U.S. bankruptcy law, it has the same meaning as the case in Chapter 11.

2. BLACK'S LAW DICTIONARY (9th ed. 2009) (Westlaw).

3. *See* Clifford J. White III & Walter W. Theus, Jr., *Chapter 11 Trustees and Examiners After BAPCPA*, 80 AM. BANKR. L.J. 289, 305-06 (2006) (noting it is impossible to have a debtor in possession (DIP) and a trustee in one reorganization case simultaneously).

4. *See* WILLIAM D. WARREN & DANIEL J. BUSSEL, BANKRUPTCY 568-88 (8th ed. 2009).

5. Steven A. Ramirez, *Subprime Bailouts and the Predator State*, 35 U. DAYTON L. REV. 81, 94-95 (2009).

though their rights have been violated.[6] This dissatisfaction often leads to stakeholder litigation. A popular cause of action is negligence in breach of the fiduciary duty of care.[7]

In the United States, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is believed to have led to a high frequency of trustee appointments.[8] Unfortunately, BAPCPA is silent on the trustee's liability for breach of duty of care, creating uncertainty for the stakeholders of the insolvent firm.[9] The courts have attempted to balance the interests of the trustees with that of the creditors and shareholders,[10] but the courts have not been uniform in the standard of review applicable to this breach.[11] A handful of circuit courts have found trustees personally liable for negligence, while other courts have held that trustees should not be subjected to personal liability unless they are found to have acted with heightened negligence, with recklessness, or fraud.[12] The U.S. Supreme Court has not provided any guidance on the subject, remaining silent on the issue.[13] But, many have found partial guidance from *Mosser v. Darrow*,[14] heard by the U.S. Supreme Court in 1951.[15]

At the other end of the earth, China continues to dismantle its inefficient economic systems formed in an earlier time under its "Planned Economy."[16] The Law of the Peo-

6. *See* David P. Primack, *Confusion and Solution: Chapter 11 Bankruptcy Trustee's Standard of Care for Personal Liability*, 43 WM. & MARY L. REV. 1297, 1312 (2002) (talking about the tension trustees are facing in reorganization cases); *see also* DiStefano v. Stern, 223 B.R. 610, 628 (Bankr. D. Mass. 1998), *aff'd*, 236 B.R. 112 (D. Mass. 1999), *aff'd*, 215 F.3d 1312 (1st Cir. 2000).

7. *See* Primack, *supra* note 6, at 1309.

8. *See* White & Theus, *supra* note 3, at 297-98 (the authors believe that the significant modifications of section 1104 will invite more Chapter 11 trustee appointments by offering judges more latitude in making appointment decisions).

9. Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 761 (5th Cir. 2000); Hutchinson v. McGee, 5 F.3d 750, 752 (4th Cir. 1993); *see also* David W. Allard, *Personal Liability of Trustees and Debtors in Possession: Review of the Varying Standards of Care in the United States*, 106 COM. L.J. 415, 416 (2001).

10. *See* Mosser v. Darrow, 341 U.S. 267, 274 (1951).

11. *Dodson*, 207 F.3d at 761.

12. *See* Allard, *supra* note 9, at 416; *see also Dodson*, 207 F.3d at 763; *In re* Chi. Pac. Corp., 773 F.2d 909, 917-18 (7th Cir. 1985); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461-62 (6th Cir. 1982); Boullion v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981); Sherr v. Winkler, 552 F.2d 1367, 1374 (10th Cir. 1977); Smallwood v. United States, 358 F. Supp. 398 (E.D. Mo. 1973), *aff'd*, 486 F.2d 1407 (8th Cir. 1973) (these courts don't follow the six other circuits, which found personal liability for mere negligence).

13. Allard, *supra* note 9, at 428-29.

14. *Mosser*, 341 U.S. at 274-75.

15. *See* Daniel B. Bogart, *Finding the Still Small Voice: The Liability of Bankruptcy Trustees and the Work of the National Bankruptcy Review Commission*, 102 DICK. L. REV. 703, 710-11 (1998); *see also* Primack, *supra* note 6, at 1312; Allard, *supra* note 9, at 428-29; Ralph C. McCullough, *Trustee Liability: Is There Enough Protection for These "Arms of the Court?"*, 103 COM. L.J. 123, 123 (1998).

16. *See* ARNALDO M. GONÇALVES, CHINA'S SWING FROM A PLANNED SOVIET-TYPE ECONOMY TO AN INGENIOUS SOCIALIST MARKET ECONOMY: AN ACCOUNT OF 50 YEARS 36 (2006), *available at* http://ssrn.com/abstract=949371 (discussing the transformation from a planned economy to a market economy in China). "Planned economy" is an economic system in which the government controls the economy. Its most extensive form is referred to as a "command economy," "centrally planned economy," or "command and control economy." Under such a system, "resource prices are in many cases distorted, failing to reflect the real value, as many types of resources are still priced by the state, operating on the inertia of the old planned economy." *Id.* at 31.

ple's Republic of China on Enterprise Bankruptcy of 2005 (New Bankruptcy Law)[17] is regarded as a great leap forward in Chinese corporate legislation, and is expected to facilitate China's reform of its economic system through standardization of the market-exit mechanism.[18] Before 2005, two laws regulated bankruptcy: Chapter XIX Procedure for Bankruptcy and Debt Repayment of Legal Person Enterprises (the Chapter XIX)[19] and the Law of the People's Republic of China on Enterprise Bankruptcy for Trial Implementation (Trial Implementation Law).[20]

Many Chinese lawyers and practitioners anxiously awaited the New Bankruptcy Law, as the then-current laws failed to regulate the bankruptcy of organizational entities such as education and partnership enterprises.[21] In 2005, the New Bankruptcy Law was promulgated and is now applicable to any type of business organization.[22] Major components of the new law include reorganization and a "bankruptcy administrator" (*Po Chan Guan Li Ren*, hereinafter "trustee"),[23] transplanted from the West.[24] However, two years after its proclamation, legal professionals have found the New Bankruptcy Law lacking as it does not properly address the trustee's liability.[25]

Article 27 of the New Bankruptcy Law stipulates, "[a] bankruptcy administrator shall be diligent and dutiful, and shall faithfully perform its duties."[26] The specific duties are enu-

17. *See* Zhông huá rén mín gòng hè guo qi yé po chan fa, (中华人民共和国企业破产法) [Law on Enterprise Bankruptcy (China)] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *available at* http://www.gov.cn/flfg/2006-08/28/content_371296.htm.

18. Zhu Hong, *Pò chan fa de xîn biàn huà*, (破产法的新变化) [The New Bankruptcy Law Changes], 9 ZHONGGUO JIN RONG [CHINA FIN.] 24, 24 (2007) (China).

19. *See* Zhông huá rén mín gòng hé guó mín shì sù sòng fa, (中华人民共和国民事诉讼法) [Law on Civil Procedure (China)] (promulgated by Order No. 44 of the President, Apr. 9, 1991, effective Apr. 9, 1991), *available at* http://www.law-lib.com/law/law_view.asp?id=7535.

20. *See* Zhông huá rén mín gòng hé guó qi yè pò chan fa (shì xíng) (中华人民共和国企业破产法(试行)) [Law on Enterprise Bankruptcy (for Trial Implementation) (China)] (promulgated by Order No. 45 of the President, Dec. 2, 1986, no longer effective), *available at* http://www.law-lib.com/law/law_view.asp?id=200.

21. *See* Zhu Hong, *supra* note 18.

22. *See* Law on Enterprise Bankruptcy (China), *supra* note 17.

23. Although in the New Bankruptcy Law the legislature uses the word "administrator," it is widely believed that the "administrator" mechanism is introduced from U.S. bankruptcy law, and its role is equivalent to a "trustee." *See* Zhu Hong, *supra* note 18; *see also* Wu Jianmin, *Xîn qǐ yè pò chan fa de chuàng xîn diǎn fçn xî* (新企业破产法的创新点分析) [The Analysis of the Innovations of the New Bankruptcy Law], 20 SHANG YE SHI DAI [COM. TIMES] 65, 66 (2007) (China); Yang Jian, *Pò chan guan li rén zhì dù ping xî* (破产管理人制度评析) [Accessing the Bankruptcy Trustee Mechanism], 512 SHANG YE XIAN DAI HUA [MARKET MODERNIZATION] 291, 291 (2007) (China).

24. *See* Yang Zhengyu, *Guân yú shěn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding de li jiě yu shì yòng* (关于审理企业破产案件确定管理人报酬的规定的理解与适用) [The Understanding and Application of the Provisions of the Supreme People's Court on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases], 11 REN MIN SI FA [PEOPLE JUSTICE] 21, 21 (2007) (China) (in this Chinese Supreme Court Journal, most of the articles are written by judges. This article discusses the process of making an explanatory judicial order by the Supreme Court on trustee's compensation. In fact, foreign legislation is the main source of reference in the procedure).

25. *See* Jiang Xinye, *Guan li rén zài pò chan chóng zhěng zhông de jué sè dìng wèi jí qí guî zhì wán shàn* (管理人在破产重整中的角色定位及其规制完善) [Regulatory Improvement and Role Orientation of Trustees in Reorganizations], 287 FA LV SHI YONG [J.L. APPLICATION] 77, 77 (2009) (China).

26. *See* Law on Enterprise Bankruptcy (China), *supra* note 17. This English translation is from a commercial legal database provider rather than an official. However, there is no official English version of the New Bankruptcy Law.

merated in Article 25,[27] while Article 27 serves as the catchall provision that allows for private suits. The vagueness of these statutes and other factors discussed herein diminish the efficacy of the trustee mechanism. The dysfunction of the trustee mechanism in China necessitates a retrospective analysis of the trustee mechanism under U.S. bankruptcy law. This article will examine trustee liability in reorganizations under U.S. bankruptcy law and related problems under China's New Bankruptcy Law. Further, this article proposes solutions to the contemporary problems of the New Bankruptcy Law.

Part II of this article provides a summary and explanation of the judicial decisions regarding the bankruptcy trustees' fiduciary duties in the United States. Part III analyzes the effect of imposing corporate fiduciary duties on a trustee and suggests further tailoring for the unique situation of the trustee. Part IV discusses the difficulties, created by improper legislation, that the Chinese reorganization trustee faces, including the lack of incentives for trustee participation, the lack of properly qualified trustees, and the disincentives for creditors to support the bankruptcy mechanism. This section will show how these problems create high practice risk and unpredictability of private enforcement. To solve the excessive risk problem and uncertainty problem, Part V proposes to reintroduce U.S. law, and the propositions developed from Parts II and III of this article, which are based on past literature of the United States, so that the New Bankruptcy Law can have a more complete and reasonable paragon from which to transplant. Part VI discusses the need to improve the trustee's fiduciary duty mechanism from a broader macroeconomic perspective and suggests using the "Case Directive" to facilitate the implementation.

II. The "Crazy Quilt"

A. WHAT IS THE "CRAZY QUILT"?

The "Crazy Quilt" is the term used in the Report of the National Bankruptcy Review Commission to epitomize the state of the law related to a trustee's personal liability.[28] Although there are a few provisions on trustee duties, no laws, including the Bankruptcy Code, provide a personal liability standard for bankruptcy trustees.[29] This lack of a stan-

27. *Id.* art. 25 (stipulating that a bankruptcy administrator shall perform the following functions and duties:

(1)Taking over the assets, seals as well as the account books and documents of the debtor;
(2)Investigating into the financial status of the debtor and formulating the financial statements;
(3)Deciding the internal management of the debtor;
(4)Deciding the daily expenditure and other necessary expenditures of the debtor;
(5)Deciding, before the first creditors' meeting is held, to continue or suspend the debtor's business;
(6)Managing and disposing of the debtors' assets;
(7)Participating actions, arbitrations or any other legal procedures on behalf of the debtor;
(8)Proposing to hold creditors' meetings; and
(9)Performing any other functions and duties that the people's court believes it should perform.

In the case of any separate provision on the bankruptcy administrator's functions and duties in the present Law, it shall prevail). This provision is very ambiguous. It is still very hard to tell whether these nine are duties or rights.

28. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 859-60 (Oct. 20, 1997).

29. *Id.* at 860-61.

dard has led many to seek interpretation from the U.S. Supreme Court case *Mosser v. Darrow*.[30] But *Mosser* has not solved the problem because some circuit courts have held trustees liable for mere negligence, extraordinary negligence, and/or fraud, while others have found judicial immunity for trustees whose acts fall within the scope of their authority.[31] The misinterpretation of *Mosser* increases the unpredictability of a trustee's personal liability in a reorganization case.[32] The circuit courts' various interpretations of *Mosser* on the standard of liability for bankruptcy trustees have led to what the Commission refers to as "a crazy quilt" of decisions.

B. THE *MOSSER* CASE AND ITS PROGENIES

Around 100 A.D., the famous Chinese general Ts'ao Ts'ao was defeated in a battle that took place in enemy territory.[33] After the battle, his troops were dispersed and a bounty was placed on his head. To avoid being discovered, the General Ts'ao fled to an old friend's home, taking his personal bodyguard with him.[34]

While resting at his friend's home, General Ts'ao overheard his friend and his friend's father say, "You can use the rope to tie. The rope in the barn is stronger and it is impossible to escape, even for a bull. I will stay here to sharpen knives. It's the time to pay him back."[35] Believing his friend was planning to do him harm, General Ts'ao and his bodyguard jumped into action and killed the eighteen people that were in the home.[36] Unfortunately, after the killings the General discovered a half-tied hog in the backyard and an unfinished banquet that was being prepared in his honor.[37]

The relationship between *Mosser* and subsequent circuit court cases follows the same logic as the above anecdotal story. The uncompromising execution based upon misinformation has resulted in irreversible loss and a great mess. In *Mosser*, a former trustee, Paul Darrow, was sued by his successor, Stacy Mosser, for permitting two former employees, Jacob Kulp and Myrtle Johnson, to trade in securities of the debtor's subsidiaries.[38] Kulp and Johnson were investigated by the Securities and Exchange Commission (SEC) for breach of loyalty for self-dealing in the companies' bonds.[39] The SEC Special Master recommended surcharging Darrow.[40] The District Court surcharged the trustee, but on appeal the Seventh Circuit reversed the decision, holding that a trustee could not be

30. *See* Primack, *supra* note 6, at 1301-05.

31. NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 28, at 860-61; *see also* Swift v. Watts, 185 B.R. 963, 970 n.7 (N.D. Ga. 1995) (explaining that absolute judicial immunity should be awarded to trustees in a bankruptcy case); Howard v. Leonard, 101 B.R. 421, 422-23 (D.N.J. 1989).

32. *See* Primack, *supra* note 6, at 1306-09 (talking about the cases on trustee liability heard by circuit courts under the influence of misinterpretations of the *Mosser* case).

33. *Ts'ao Ts'ao*, ENCYCLOPEDIA OF WORLD BIOGRAPHY (2004), http://www.encyclopedia.com/topic/Tsao_Tsao.aspx.

34. Morgan Evans, *Cao Cao (Mengde)*, BIOGRAPHY OF CAO CAO, 2004, http://kongming.net/novel/sgyy/caocao.php.

35. *Id.*

36. *Murder of Lu Boshe*, CAO CAO, http://cao-cao.co.tv/#Murder_of_L_Boshe (last visited May 15, 2011).

37. *Id.*

38. *Mosser*, 341 U.S. at 268-70.

39. *Id.*

40. *Id.* at 270.

surcharged unless he was guilty of "supine negligence."[41] The Supreme Court reversed the Seventh Circuit's decision and found Darrow personally liable for the indiscrete actions of Kulp and Johnson.[42] Justice Jackson delivered a narrow opinion for the Court.[43] In *Mosser*, Darrow knowingly contracted with Kulp and Johnson, resulting in the underlying breach.[44] Such action was beyond the trustee's authority and therefore Darrow's willful and deliberate act breached the trustee's fiduciary duty.[45] The Court provided very important guidance in judging the standard of trustee's duty in reorganization, stating:

> Trustees are often obliged to make difficult business judgments, and the best that disinterested judgment can accomplish with foresight may be open to serious criticism by obstreperous creditors aided by hindsight. Court[s] are quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment. But a trusteeship is serious business and is not to be undertaken lightly or so discharged. The most effective sanction for good administration is personal liability for the consequences of forbidden acts, and there are ways by which a trustee may effectively protect himself against personal liability.[46]

The Court discussed the trustee's willful and deliberate breach of his fiduciary duty. This decision should be read narrowly, as the *Mosser* Court did not address a trustee's personal liability with regard to negligent actions.[47] In dicta, *Mosser* has provided guidance and a starting point for later courts.[48] But later courts have misconstrued the opinion of *Mosser*.[49] Like General Ts'ao, the lower courts have misunderstood the U.S. Supreme Court's message in *Mosser* and have incorrectly applied a broad brush in their formulations of a standard of fiduciary duty for the reorganization trustee.

Different interpretations of the *Mosser* ruling have led to different results in the later courts, even within the same circuit. The Fifth Circuit in *Boullin v. McClanahan*[50] ruled that trustees are protected by derived judicial immunity.[51] But in *In re Miller Smyth, III*, the Fifth Circuit held that "trustees should not be subjected to personal liability unless they are found to have acted with gross negligence."[52] The Tenth Circuit in *Sherr v. Winkler* held trustees will *only* be held liable for willful and deliberate acts.[53] More interestingly, the court opined:

> *Mosser v. Darrow* . . . established the rules that a trustee or receiver in bankruptcy is (a) not liable, in any manner, for mistake in judgment where discretion is allowed, (b)

41. *Id.* at 272.
42. *Id.* at 270.
43. Primack, *supra* note 6, at 1302.
44. *Mosser*, 341 U.S. at 272.
45. *Id.*
46. *Id.* at 273-74.
47. *Id.* at 270; Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 761 (5th Cir. 2000).
48. Primack, *supra* note 6, at 1304.
49. *Id.* at 1306.
50. Boullion v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981).
51. *Id.*
52. *Dodson*, 207 F.3d at 762.
53. Sherr v. Winkler, 552 F.3d 1367, 1375 (10th Cir. 1977).

liable personally only for acts determined to be willful and deliberate in violation of his duties and (c) liable, in his official capacity, for acts of negligence.[54]

The U.S. Supreme Court did not expressly provide any such rules.[55] Some academics have doubted whether the Supreme Court implied such beliefs in its dicta.[56] The inconsistent lower court rulings regarding the standard of the trustee's fiduciary duty confuse both legal professionals and trustees alike. Unfortunately, the revision of bankruptcy law in 2005 still leaves this issue untouched.[57] One vital goal of any commercial law regime is certainty and finality of transactions.[58] It is imperative to consolidate and harmonize past court decisions with academic insights to construct a reasonable and widely acceptable standard that is a valuable reference for courts, trustees, and the legislature.

C. Two Different Perspectives and One Confusion

1. *Why Bifurcated?*

After *Mosser*, later court decisions can be classified into two schools, those applying the "negligence standard" and those applying the "heightened standard."[59] The courts that follow the negligence standard believe that trustees should be found in breach of a fiduciary duty when the trustee acts negligently.[60] The courts that follow the heightened standard are more lenient and will only find a breach if the trustee acts with gross negligence or commits willful and deliberate acts.[61] The circuit courts do not provide proper rationale as to why they opt for either standard.[62] But it is not too difficult to speculate on the reasons. As mentioned in the introduction of this article, protecting innocent and hard-working trustees and providing adequate protection to the estate and creditors are the issues at stake in these court decisions.

For policy reasons, the heightened standard gives trustees protection from "criticism by obstreperous creditors aided by hindsight."[63] The crucial question here is whether the heightened standard is a *sine que non* to protect innocent and hard-working trustees properly. Will trustees be in jeopardy or be unfairly treated if we apply the lower negligence standard? Is there any other option that will bring less adjudicative confusion and inconsistency and fit better into the common law fiduciary duty system? This article will try to answer these questions by examining the common law fiduciary duty from a theoretical perspective in Part III.

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54. *Id.*

55. *See generally* Mosser v. Darrow, 341 U.S. 267, 268-70 (1951).

56. *See, e.g.*, Primack, *supra* note 6, at 1306.

57. *See generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-9, 119 Stat. 23 (2005).

58. *See, e.g., In re* Kontrick, 295 F.3d 724, 732 (7th Cir. 2002) (specifically recognizing the "Bankruptcy Code's goal of promoting certainty and finality for debtors").

59. *Compare* Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 762 (5th Cir. 2000) (heightened standard), *and* Boullion v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981) (heightened standard), *with* Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1977) (negligence standard).

60. *See, e.g., Sherr*, 552 F.3d at 1375.

61. *See, e.g., Dodson*, 207 F.3d at 762; *Boullion*, 639 F.3d at 214.

62. *See, e.g., Dodson*, 207 F.3d at 762; *Boullion*, 639 F.3d at 214; *Sherr*, 552 F.3d at 1375.

63. *See Mosser*, 341 U.S. at 273-74 (1951). This consideration can be found in the *Mosser* case, even though it is not a "heightened standard" case.

2. *Absolute Judicial Immunity*

Given the U.S. Supreme Court's ambiguous stance on willful and deliberate acts, later courts have developed the "absolute judicial immunity" doctrine.[64] Although there are subtle differences among the applications of the absolute judicial immunity doctrine,[65] the application condition of judicial immunity has been misunderstood. The absolute judicial immunity doctrine only applies when trustees are acting within the scope of their duties or executing a specific bankruptcy court order and are sued by a third party, rather than by any bankruptcy parties in interest.[66]

According to the doctrines of judicial and sovereign immunity, judges and government defendants are immune from any lawsuits when they are challenged regarding actions performed within the scope of their duties.[67] In *Gregory v. United States/U. S. Bankruptcy Court*, the court found that a trustee merely executing the bankruptcy judge's orders is protected from any lawsuit regarding the execution of those orders.[68] This immunity is called quasi-judicial immunity.[69] There should not be any doubt cast on this immunity, because trustees executing court orders are just like judicial clerks enforcing judges' orders. Following this rationale, if trustees voluntarily or involuntarily incur third party liability while acting within the scope of their duties (such as entering into or breaching a contract), the estate should bear the legal consequences rather than the trustees.[70] This follows the same logic as that of the management's agent immunity in daily business operation of a solvent firm; because management was hired by the corporation, the actions of management are regarded as the actions of the corporation. Some literature recognizes the legitimacy of this immunity, although it has many names.[71]

Such immunity should not be broadened to include the conduct of the trustee that is not expressly approved by the court.[72] This is because the inherent relationship of the trustee and the stakeholders is one of trust, and the trust between the fiduciaries and the

64. Swift v. Watts, 185 B.R. 963, 970 (Bankr. N.D. Ga. 1995); Howard v. Leonard, 101 B.R. 421, 422-23 (D.N.J. 1989); *Boullion*, 639 F.2d at 214.

65. In the *Howard* opinion, the court held that:

> It is axiomatic that judges are absolutely immune from civil liability for damages for their judicial acts . . . Absolute judicial immunity has been extended to those non-judges whose duties and functions are 'an integral part of the judicial process.' Absolute immunity has been specifically conferred on trustees in bankruptcy. Because a trustee's immunity is derived from that afforded to the bankruptcy judge, a trustee will enjoy absolute immunity so long as he does not act in the clear absence of all jurisdiction, or at least acts under the supervision of the bankruptcy judge.

Howard, 101 B.R. at 422-23. But in the *Boullion* case, the judge found a "trustee acting at the direction of a bankruptcy judge is clothed with absolute immunity against tort actions grounded on his conduct as trustee." *Boullion*, 639 F.2d at 214.

66. *See* Bogart, *supra* note 15, at 717-20.

67. Gregory v. United States/U.S. Bankr. Court, 942 F.2d 1498, 1500 (10th Cir. 1991).

68. *Id.*

69. *Id.* at 1500 n.1.

70. *In re* Chi. Pac. Corp., 773 F.2d 909, 916 (7th Cir. 1985) (Wood, J., holding that trustee owed no fiduciary duty to the third party (vendors) and thus could not be sued in his personal capacity).

71. *See* Bogart, *supra* note 15, at 717 (discussing the derived judicial immunity that kicks in when trustees act within the scope of their duties and are sued by a third party).

72. *Id.* at 720.

beneficiaries deserves the protection of the fiduciary rules.[73] According to Frank Easterbrook and Daniel Fischel, "a 'fiduciary' relation is a contractual one characterized by unusually high costs of specification and monitoring."[74] This is especially true in the reorganization trusteeship context as a bankruptcy trustee may be selected by the parties in interest, creditors, and shareholders, or by the courts.[75] The trustee is paid based on their management of the insolvent business.[76] If trustees can claim immunity from a breach of duty of care or duty of loyalty, the fiduciary relation between trustees and parties in interest will be rendered meaningless.

Admittedly, trustees do have immunities.[77] But those immunities are available only when trustees act in a judicial agent capacity, or an organizational agent capacity towards a third party.[78] Similarly, the board of directors of a company enjoys the protections of the business judgment rule, but not absolute immunity.[79] Arbitrarily inserting absolute immunity into the fiduciary relationship, which is a contributory cause to the series of "Crazy Quilt" decisions, will invite inconsistency of adjudications. There is a significant amount of literature, including the Report of the National Bankruptcy Review Commission, which suggests that corporate fiduciary duties should be transplanted into the bankruptcy trustee context.[80] Does the corporate fiduciary duty fit into the bankruptcy trustee context? And if so, do the duties need to be tailored?

III. Corporate Fiduciary Duty, an Elixir?

A. A Controversial Solution: Corporate Law's Standard of Review

In reorganizations, trustees have a multitude of tasks, such as assuming or rejecting contracts, conducting a sale, avoiding preferential or fraudulent transactions, accounting for property, and examining and objecting to claims.[81] Given that the business is insolvent, a trustee's work can have greater risk than that of management of a solvent firm. The trustee must operate the firm's daily management while dealing with the many problems that arise under the firm's deteriorating financial situation.[82] It is not a sagacious choice to leave such an important job unregulated or subject to the highly repugnant

73. *See* E. Allen Tiller, *Personal Liability of Trustees and Receivers in Bankruptcy*, 53 Am. Bankr. L.J. 75, 76 (1979).

74. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. L. & Econ. 425, 427 (1993).

75. *See* 11 U.S.C.A. § 1104 (2006).

76. *See* 11 U.S.C. § 326 (2006).

77. *See, e.g.*, Bogart, *supra* note 15, at 717.

78. *Id.* at 717-20.

79. Black's Law Dictionary (9th ed. 2009) (Westlaw).

80. *See, e.g.*, Primack, *supra* note 6, at 1299; *see also* Alexander Wu, *Motivating Disclosure by a Debtor in Bankruptcy: The Bankruptcy Code, Intellectual Property, and Fiduciary Duties*, 26 Yale J. on Reg. 481, 481 (2009).

81. *See* 11 U.S.C.A. § 1106 (2006) (setting forth duties of a trustee).

82. *Id.*

present judicial review standards.[83] To clear up the mess of the "Crazy Quilt" of decisions, the Report of the National Bankruptcy Review Commission suggested:

> A Chapter 11 trustee of a corporate debtor only should be subject to suit in the trustee's representative capacity and subject to suit in the trustee's personal capacity only to the extent that the trustee has violated the standard of care applicable to officers and directors of a corporation in the state in which the Chapter 11 case is pending.[84]

The Committee believes that incorporating corporate fiduciary duty into the trustee fiduciary duty system would clear up the current mess.[85] Other literature also supports the proposition that incorporation of the corporate director's standard of review into the bankruptcy trustee context is the best solution to solve "Crazy Quilt" problem.[86] Corporate fiduciary duties have had a long period of review by the courts and are therefore systematical and comprehensive duties. Considering the highly similar functions and responsibilities between corporate directors and trustees in reorganization, it is the optimal solution to the confusion regarding trustees' fiduciary duties. But there is still a lot of academic debate on whether the solution is viable.[87]

The proponents of the incorporation of a corporate law standard of review believe that it will provide trustees enough latitude in reorganization while also protecting the estate and creditor by requiring trustees to make informed, reasonable decisions.[88] Opponents attack the incorporation of corporate fiduciary law in two ways by arguing that: (1) the incorporation would create fifty different fiduciary standards for Chapter 11 trustees and (2) the contractual explanation of corporate fiduciary duty does not make sense in the reorganization trustees' scenario.[89] But these attacks are vulnerable and rebuttable.

First, the creation of fifty different fiduciary standards for Chapter 11 trustees does not really matter. Fiduciary duties are contextual[90] and therefore are "one of the most elusive concepts in Anglo-American law."[91] Thus there is no unified corporate fiduciary duty.[92] The facts speak for themselves. After about 180 years of practice, generations of legal professionals have not found a unified corporate fiduciary duty that can replace a context-specific approach.[93] Currently, no one can assert what specific adverse effects will be in-

83. For examples of these unsettled judicial review standards, *see* Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 762 (5th Cir. 2000); Boullin v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981); *Sherr v. Winkler*, 552 F.3d 1367, 1375 (10th Cir. 1977).

84. NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 28, at 842. This provision was not adopted during the 2005 bankruptcy law revision. *See generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-9, 119 Stat. 23 (2005).

85. NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 28, at 842.

86. *See, e.g.*, Primack, *supra* note 6, at 1319-20; Wu, *supra* note 80, at 499-502.

87. *See, e.g.*, Bogart, *supra* note 15, at 736-44.

88. *See, e.g.*, Primack, *supra* note 6, at 1320.

89. *See, e.g.*, Bogart, *supra* note 15, at 737.

90. *See, e.g.*, Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1400 (2002); A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L. J. 879, 879 (1988).

91. DeMott, *supra* note 90, at 879.

92. Although there are some widely recognized directive corporate fiduciary duty model acts, such as the Model Business Corporation Act, they are not valid and enforceable law. *See* MODEL BUS. CORP. ACT § 8.31 (2008) (introducing a general standard of corporate fiduciary duty).

93. *See* S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 93, 96-97 (1979).

vited by applying state corporate law fiduciary duty. Additionally, in a bankruptcy case it is barely news that judges look into specific applicable state law to decide specific matters, such as whether contracts are assumable or assignable. State laws work perfectly in the bankruptcy context as long as they have been tailored properly. There are no adverse dynamics between codified bankruptcy law and state corporate fiduciary laws.

Second, viewing the relationship of fiduciaries as one of contract is not a complete approach. Although law on the fiduciary duty is "messy," many U.S. scholars have successfully crafted a unified theory of fiduciary duty.[94] The contractual explanation of corporate fiduciary duty is but one of these approaches and is not perfect—even if it is the most widely endorsed theory in academia.[95] Professor Roberta Romano commented on this theory as a "valuable contribution to our understanding of fiduciary duty law" and one that still needed to be fully elaborated.[96] There is an array of compelling theories that can be used to explain the fiduciary relationship, such as "critical resource" theory and "trust-vulnerability" theory.[97] Why should the contractual explanation be the only justification for the existence of fiduciary duty? Additionally, courts typically do not attempt to explain why fiduciary duties are imposed in formal fiduciary relationships. From the judiciary's perspective, many of these relationships have been considered fiduciary in nature for centuries, and any attempt to explain that status seems unnecessary. Therefore, whether contractual explanation makes sense in a reorganization trustee scenario should not be controlling in the pursuit of bankruptcy law certainty.

In sum, the Report of the National Bankruptcy Review Commission's suggested approach to the incorporation of corporate fiduciary duty into the bankruptcy trustee context is a viable solution to standardizing judicial review. Further, current opponents' arguments are not theoretically compelling. But the questions that must be answered are whether the differences between corporate directors' functions in a solvent firm and trustees' functions in an insolvent firm matter in incorporating corporate fiduciary duty to reorganization trustees' duty and whether the different dynamics between management and its beneficiaries in both solvent and insolvent firms can be ignored.

B. Different Works, Same Duty? The difficulty of applying the same standard

As mentioned previously, fiduciary duties should be measured contextually.[98] Thus, it is inappropriate to apply a strict standard to a possible breach of duty without attention to the facts. When looking to incorporate corporate duties, the bankruptcy trustee's situation must be considered. Changes should be made to the application of the corporate duties to allow for an efficient relationship between the trustees and stakeholders.

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94. *See, e.g.*, Smith, *supra* note 90, at 1400.

95. *See, e.g.*, Easterbrook & Fischel, *supra* note 74.

96. *See* Roberta Romano, *Comment On Easterbrook and Fischel, "Contract and Fiduciary Duty"*, 36 J.L. & Econ. 447, 450 (1993).

97. *See, e.g.*, Smith, *supra* note 90, at 1431; Tamar Frankel, *Fiduciary Law*, 71 Cal. L. Rev. 795, 810 (1983); Austin W. Scott, *The Fiduciary Principle*, 37 Cal. L. Rev. 539 (1949); L.S. Sealy, *Fiduciary Relationships*, 1962 Cambridge L.J. 69; J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q. Rev. 51, 51 (1981).

98. *See* Smith, *supra* note 90, at 1400.

Operational strategies of a trustee and director are dissimilar. Although most daily work performed by reorganization trustees and directors in a solvent firm are not significantly and essentially different, the nuances between different working situations and decision procedures still matter in deciding whether they deserve the same standard of review.

First, directors manage a company in good or bad financial situations, while trustees by the nature of the situation are managing failing businesses. In such a situation, there are fewer opportunities and it is more difficult to find creditors that will loan money to the floundering firm. Deficits are found on the books. Further, if former management affected fraudulent transactions that contributed to the current failing state of affairs, such transactions are likely to be well hidden from discovery. Is it fair to impose the same standard of review against these struggling reorganization trustees? Second, making a business decision in a solvent firm is easier than in a bankruptcy. For example, it is much easier for a succeeding or performing enterprise to raise capital. After the famous case of *Smith v. Van Gorkom*,[99] the business judgment rule has been shaped into one that shields directors from more exacting levels of review once some conditions, such as proper outsourcing or ample meeting time, are met.[100] Unfortunately, these specified conditions usually include hiring expensive outside consultants, such as investment banks, to justify important management decisions.[101] This expensive action may be too luxurious for trustees in reorganization because there are limited funds available. Trustees must find cost-saving ways to resurrect the deteriorating business rather than diminishing creditors' bankruptcy dollars with meaningless outsourcing to protect themselves from exacting judicial review.[102] If courts impose the prerequisites of the business judgment rule on reviewing trustees' acts in reorganization, it will exacerbate the intensive tension between trustees and beneficiaries. Trustees might lower their practice risks by squandering beneficiaries' resources. If the estate ends up in liquidation, then the beneficiaries are worse off. Third, in reorganization, trustees are facing indignant creditors, who are ready to sue when they perceive any sloppy business decisions being made by the trustee. Collective action problems[103] in reorganization cases occur far less often than in solvent firms, because creditors, unlike shareholders, cannot "vote with their feet."[104] Therefore, creditors

99. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

100. *See* Charlie Xiao-chuan Weng, *Assessing the Applicability of the Business Judgment Rule and the "Defensive" Business Judgment Rule in the Chinese Judiciary: A Perspective on Takeover Case Adjudications*, 34 FORDHAM INT'L L.J. 124, 129 (2010) (explaining the business judgment rule and its application conditions).

101. *Van Gorkom*, 488 A.2d at 858; Joseph W. Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968).

102. *See* Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 927 (1983) (criticizing outsourcing and time wasting procedure as redundant, even for corporate directors).

103. "Diffuse stock ownership presents shareholders with formidable collective action problems in attempting to exercise their control right." Some shareholders considering cost-benefit effects will not exercise their ownership right, resulting in management having more latitude in making business decisions. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 62 (2d ed. 2009).

104. Shareholders can express their dissatisfaction with managements' decisions by selling the stocks they holding. *See, e.g.*, Eric M. Forgel, David I. Addis & Edward C. Harris, *Public Shareholders Acting Like Owners: Three Reforms-Introducing the "Oversight Shareholder,"* 29 DEL. J. CORP. L. 517 (2004); *see also* ROBERT PARINNO, ET AL., VOTING WITH THEIR FEET-INSTITUTIONAL INVESTORS AND CEO TURNOVER (Jan. 3, 2002), *available at* http://www.mccombs.utexas.edu/aimcenter/Working%20Papers/Parrino2.pdf.

must act quickly and actively; otherwise, they probably will end up with nothing. If trustees cannot be awarded more protection, they will face more negligent lawsuits than corporate directors do.

Corporate fiduciary duties are the best example for reorganization fiduciary duties to learn from because of their sophistication and applicability to reorganization fiduciary duties. But given the differences of their tasks and fiduciary-beneficiary dynamics, corporate fiduciary duties need to be better tailored to the needs of reorganization. Corporate fiduciary duties should provide an optimal foundation for the reorganization fiduciary duty to build upon. Some revisions are necessary. Through taking one more step, a more suitable standard of review can be established.

C. The Path of How to Tailor

How to tailor the corporate fiduciary duty is the last problem that must be tackled to incorporate it properly into the reorganization trustees' fiduciary duty mechanism. The key to this last problem is how to keep the appropriate tension between protecting innocent, hard-working trustees while providing adequate protection for the estate and creditors. As mentioned earlier, there is no significant difference between the daily operations of a trustee in reorganization and a corporate director.[105] Therefore, we can incorporate corporate fiduciary duties as a foundation for trustee fiduciary duties. By doing so, this solves the estate and creditors' protection problem by providing private parties, such as creditors and investors, with a tool for private enforcement.[106] To restrict the discretion of adjudicators in determining whether a violation has occurred, thus protecting the honest trustees,[107] the business judgment rule can be used.[108] But is the business judgment rule suitable for trustee fiduciary duty?

If management's actions meet the standard of conduct set by common law, the business judgment rule would apply. The standard of conduct applicable to directors and officers of U.S. corporations is set forth in Section 4.01(a) of the American Law Institute's Principles of Corporate Governance.[109] It is a fairly demanding standard, but the standard of review applied to the performance of these duties is less stringent.[110] When directors' and officers' decisions are called into question, as long as all four of the conditions of the business judgment rule are met judges will not question management's decisions.[111] The four conditions are: (1) directors must have made a decision; generally, the rule is inappli-

105. *See* Primack, *supra* note 6, at 1299.

106. *See* Kraakman et al., *supra* note 103, at 39.

107. *Id.* at 40.

108. *See* Weng, *supra* note 100, at 127-30.

109. Section 4.01(a) of American Law Institute Principles of Corporate Governance reads:

> A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 4.01(a) (1994).

110. *See* Melvin Aron Eisenberg, Corporations and Other Business Organizations 545 (8th ed. 2000).

111. *Id.* at 540.

cable to an omission; (2) directors may not have an interest, personally or financially, in the subject-matter; if the interest will reasonably be expected to affect their judgment, the standard of review will be heightened and the business judgment rule will be inapplicable; (3) directors must have employed a reasonable decision making process; this is the justification that enables directors to reasonably make appropriate decisions; and (4) decisions should be made in good faith; if the decision breaches the law, the business judgment rule is inapplicable.[112] The standard of conduct seems highly consistent with the trustee scenario. But, as mentioned before, the third condition, "reasonable decision making process," will invite some trouble.

The business judgment rule is applicable in some important situations, such as during a takeover; and, when certain procedural requirements are met,[113] management can entrench themselves from more exacting judicial review.[114] But this strategy does not seem to be the best for trustees of an insolvent firm. It is improper to excuse all trustee decisions under the business judgment rule, as many agency problem-preventing mechanisms, such as the exit mechanism, are not an option in reorganization.[115] Nevertheless, trustees should be more prudent on crucial issues to protect the estate and creditors from sloppy decisions. Some courts have held that trustees are liable for mere negligence through this reasoning.[116] If there are no special requirements for trustees in making important decisions, the balance of protection between the estate and creditors, on the one hand, and trustees, on the other hand, will be broken. The disproportionate protection will disincentivize trustees to act appropriately and leave beneficiaries unable to protect themselves through litigation.

Further, the business judgment rule must not have judicial approval as a prerequisite since the purpose of the business judgment rule is to prevent judges, who typically have no business experience, from meddling in fiduciaries' business decisions.[117] Even the most learned judges cannot assert that they know the market and business better than trustees. It is much wiser to have courts scrutinize how trustees came to make a decision rather than to scrutinize the business decision itself.

Only in very rare cases will a bankruptcy judge decide to specifically pre-approve a trustee's acts. For instance, a court would not like to authorize the specific steps the trustee took in conducting a sale. Therefore, it is practically unviable and theoretically unreasonable to require court approval for the business judgment protection. A better approach that is both low-cost and effective would be to require disclosure.

Disclosure plays a fundamental role in controlling agency problems.[118] Although mandated disclosure is criticized as ineffective in many situations,[119] it would work perfectly by

112. *Id.* at 545.

113. *Id.* at 540.

114. *See* Weng, *supra* note 100, at 128-29.

115. *See* KRAAKMAN ET AL., *supra* note 103, at 39-45.

116. *See, e.g.*, Park v. Perry, 703 F.2d 1339 (9th Cir. 1983).

117. *See* Melvin Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 444 (1993).

118. *See* Weng, *supra* note 100, at 49. In the *Mosser* case, Justice Jackson also underscored the importance of disclosure in trustee fiduciary duty. *See Mosser*, 341 U.S. at 274 (1951).

119. *See, e.g.*, Omri Ben-Shahar & Carle E. Schneider, *The Failure of Mandated Disclosure* 5 (John M. Olin Law & Economics Working Paper No. 516, 2010), *available at* http://www.law.uchicago.edu/files/file/516-obs-disclosure.pdf (discussing the systematic failure of mandated disclosure. The authors believe that, first,

ad hoc disclosure in reorganization. Mandated disclosure is less efficient when: (1) disclosees do not receive information; (2) disclosees do not read disclosed information, do not understand it when they read it, or do not use it even if they understand it, (*e.g.* consumers don't read and understand the Truth-in-Lending Act (TILA) disclosures); and (3) disclosees' decisions are not improved by the mandatory disclosures.[120] But these concerns are unwarranted in reorganization. First, interested parties in bankruptcy are more active than other disclosees in acquiring information related to their interests, because the cost of being inert will result in fewer bankruptcy dollars if the reorganization fails. And the chances are high that the reorganization will fail.[121] Second, interest groups not only will read any *ad hoc* disclosure, but will also evaluate the quality of the trustee's decision. In most commercial firm reorganizations a large portion of creditors are businessmen or bankers. They are very sensitive to any bad decision. Sometimes, they are even more sophisticated in the business than the trustees themselves. Third, although disclosure will not improve beneficiaries' decisions because beneficiaries are bonded with the distressed operating business, it will assist in raising a red flag if there are any fraudulent activities. This will allow interested parties to petition the bankruptcy court *ex ante* to prevent bad business decisions or *ex post* for discovery in a lawsuit for breach of fiduciary duty. Most importantly, *ad hoc* disclosure can be viewed as part of a reasonable decision making process and can avail the protection provided by the business judgment rule. Thus, through the protection of the business judgment rule and disclosure, trustees will be capable of making decisions that have the appropriate amount of risk.[122]

Having tackled the core question—the standard of review—we turn our attention to the duties of loyalty and immunity. Fortunately these are not very complex issues. *Mosser* states that no court will excuse any intentional breach of duty.[123] On this point, there is no difference between the literature and the courts' application of the rule.[124] Any willful and deliberate infringement on the beneficiaries should be regarded as a breach of fiduciary duty. Given that the breach of duty of loyalty is always a deliberate, intentional, and self-interested act, the business judgment rule is inapplicable.[125] Immunity only exists when either the: (1) trustee causes damage to a third party while acting within the scope of its duty;[126] or when (2) the trustee's acts are specifically approved by the courts.[127] No immunity is applicable when trustees negligently or purposely cause beneficiaries damage,[128] even if under the courts' general approval.

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mandated disclosure rests on false assumptions about how people live, think, and make decisions. Second, it rests on false assumptions about the decisions it intends to improve. Third, its success requires an impossibly long series of unlikely achievements by lawmakers, disclosers, and disclosees. That is, the prerequisites of successful mandated disclosure are so numerous and so onerous that they are rarely met).

120. *Id.* at 15.

121. *See* WARREN & BUSSEL, *supra* note 4, at 573-693.

122. *See* DAVID A. SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA 205 (2005).

123. *See Mosser*, 341 U.S. at 267 (1951).

124. *Id.*

125. *See, e.g.*, Bayer v. Beran, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944) ("The 'business judgment rule,' however, yields to the rule of undivided loyalty. This great rule of law is designed 'to avoid the possibility of fraud and to avoid the temptation of self-interest.'").

126. *See* Bogart, *supra* note 15, at 717-20.

127. *See* Tiller, *supra* note 73, at 75.

128. *See* Bogart, *supra* note 15, at 720.

IV. Trustee in Reorganization of the New Chinese Bankruptcy Law: An Improved Vehicle, But Only Half Way

A. Legislative History

Chinese bankruptcy legislation has evolved through three stages. In the first stage, before 1984, known as the Planned Economy period, no bankruptcy law was promulgated.[129] During the Planned Economy[130] period, all transactions were organized by the government per the plan made at the beginning of each period. Enterprises focused on assigned tasks rather than profitability. As a result, business organizations could not go into bankruptcy voluntarily or be forced into involuntary bankruptcy.

The second stage occurred from 1984 to 2007. After the "Open Door" policy became effective in 1978, most of China's state-owned enterprises (SOEs) were suffering serious debt problems. In an attempt to transform the Planned Economy into a "Market Economy," the legislature promulgated the first Chinese bankruptcy regulation. In 1984, the Trial Implementation created a legalized SOEs market exit mechanism instead of an administrative market exit mechanism.

Over the next several years, the ratio of private economy to national economy skyrocketed.[131] And since the Trial Implementation did not apply to private firms,[132] the 1991 legislature incorporated Chapter XIX into civil procedure law, which allowed for bankruptcy of private companies.[133] Both the Trial Implementation and Chapter XIX came out with a strong administrative influence. Although the Trial Implementation has a reorganization mechanism that subordinates commercial credit claims to employee payment claims and government property rights,[134] the reorganization management "Liquidation Group" (*Qing Suan Zu*) consists of government officials who know more about how to reallocate and comfort employees than how to run business.[135] Because of this lack of professionalism and financial focus, twenty-one years of the Trial Implementation[136] led to no successful reorganizations.[137] All reorganizations unanimously failed.

After a nearly thirty-year incubation period, the New Bankruptcy Law was enacted in 2006 and implemented in 2007.[138] This is the third stage. The New Bankruptcy Law is widely considered as the first modernized and market economy oriented bankruptcy law.

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129. *See* Gonçalves, *supra* note 16, at 20-21.

130. *Id.* at 1.

131. From 1978 to 2006, SOE's share in national economy fell from 82% to 9.1%. *See, e.g.*, Yin Xiuchao, *Zhông guó pò chan fa li fa jin chéng de hui gù yu zhan wàng* (中国破产法立法进程的回顾与展望) [Retrospect and Forward Looking to Chinese Bankruptcy Legislation Progress], *available at* http://www.chinalaw.org.cn/Column/Column_View.aspx?ColumnID=396&InfoID=1614.

132. Law on Enterprise Bankruptcy (for Trial Implementation) (China), *supra* note 20.

133. Law on Civil Procedure (China), *supra* note 19.

134. Gonçalves, *supra* note 16, at 2.

135. *See* Yang Jian, *Pò chan guan li rén zhì dù ping xî* (破产管理人制度评析) [Accessing the Bankruptcy Trustee Mechanism], 512 Shang Ye Xian Dai Hua [Market Modernization] 291, 291 (2007).

136. The Trial Implementation was officially effective from 1986 to 2007. *See* Law on Enterprise Bankruptcy (for Trial Implementation) (China), *supra* note 20.

137. Gonçalves, *supra* note 16, at 2.

138. Zhông huá rén mín gòng hè guo qi yé po chan fa, (中华人民共和国企业破产法) [Law on Enterprise Bankruptcy (China)] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *available at* http://www.gov.cn/flfg/2006-08/28/content_371296.htm.

It is the first time that commercial credit claims have been ranked ahead of employee payment claims and states' property rights.[139] The New Bankruptcy Law transplanted the bankruptcy trustee and reorganization mechanisms from U. S. Bankruptcy Code.[140] But they are not well tailored to fit the Chinese judiciary.

B. Dilemmas of Trustee Mechanism and Where They Come From

1. *The Dilemmas*

Because of the institutional defects of the bankruptcy trustee mechanism, few professionals wish to be trustees. This lack of interest has led to a shortage of trustees for the bankruptcy courts. Most trustees are professionals from law firms and accounting firms.[141] In Fujian province, where there were 367 law firms and 4,163 lawyers in 2007, only twenty-five law firms and fifty-nine individual lawyers applied for trustee candidacy.[142] Of these, only fifteen law firms and nine individual lawyers were selected to serve as trustee.[143] The average number of bankruptcy cases for a province of Fujian's size is above 200 per year.[144]

Further exacerbating the problem, trustees' skills are far from satisfactory. Given that the practice risk is extremely high[145] and that payment for a trustee is uncertain,[146] professionals that do enter into the field intend to stay.[147] As a result, trustees prefer to solicit opinions from the courts to make up for their meager professional skills and to protect against creditors' complaints.[148] This turns bankruptcy courts into *de facto* trustees.[149] Many bankruptcy judges complain that their workloads are far heavier since the proclamation of the New Bankruptcy Law.[150]

From the perspective of the financially interested parties, the new reorganization trustee mechanism is not much better than the Liquidation Group. Under the New Bankruptcy Law, creditors have no say as to the selection of a trustee.[151] Nor do bankruptcy courts. According to the China Supreme Court, bankruptcy courts have no latitude in

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139. *See, e.g.*, Zhu Hong, *supra* note 18.

140. *See id.*

141. *See* Yang Zhengyu, *Guân yú shěn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding de l? jiě yu shi yòng* (关于审理企业破产案件确定管理人报酬的规定的理解与适用) [The Understanding and Application of "the Provisions of the Supreme People's Court on the Payment of Administrators during the Trial of Enterprise Bankruptcy Cases"], 6 Ren Min Si Fa [People Justice] 21, 23 (2007).

142. *See* You Bingning, *Zhí yè fçng xi?n kòng zhì wo guó pò chan guan li rén zhì dù de wán shàn* (执业风险控制：我国破产管理人制度的完善) [Practice Risk Control: the Suggestions of Chinese Bankruptcy Trustee Mechanism],11 Ren Min Si Fa [People Justice] 33, 35 (2009).

143. *See id.*

144. The number of bankruptcy cases for the Fujian province in 2007 is not available. But if we look at the number of cases in a similarly sized province, Fujian Province's number would not be below 200. *See* Yang Zhengyu, *supra* note 141, at 24.

145. *See id.* at 22.

146. *See* You Bingning, *supra* note 142, at 36.

147. *See* Jiang Xinye, *supra* note 25, at 78.

148. *See* You Bingning, *supra* note 142, at 36.

149. *Id.*

150. *Id.* at 33.

151. *See* Jiang Xinye, *supra* note 25, at 79.

selecting trustees; all trustees are picked randomly out of a candidate pool.[152] The worst part is that due to the incompleteness of the trustee fiduciary duty mechanism, it is very tough for creditors to sue successfully trustees for sloppy and unprofessional management. If the court grabs a bad apple creditors have no choice but to take it. The reorganization trustee mechanism is in jeopardy.

2. *The Causations of Dilemmas*

The three reorganization problems of lack of participation, a lack of professional skills, and creditors' disfavor of the mechanism greatly dampen the efficacy of the reorganization trustee mechanism. These problems are deeply rooted in China's legal tradition. High practice risk and the unpredictability of private enforcement create these dilemmas. If these two issues can be resolved, the reorganization trustee mechanism will be a real advanced mechanism in increasing the value of an insolvent firm.

High practice risk is created by the uncertainty in bankruptcy administration. With potential liabilities being greater than potential rewards, professionals have little interest in working as a trustee. Further, for these professionals to improve their skills, they must invest time and money. But if professionals cannot rely on a return on their investment, they will not make that investment. Also, when making a decision for the insolvent firm the trustee is more likely to make the easiest and safest decision, which is not always in the best interest of the insolvent firm. Given that different professionals have different marginal product of capital, which means that the better the professional is, the higher the payback will be, a job with uncertain compensation and potential high litigation risk cannot acquire the best professional for the job. If the payback is low and uncertain, only the less trained and less compensated professionals will apply for this job. That is what is happening in China.[153]

In practice, cash is always a significant problem for an insolvent firm. It is not uncommon for trustees to cover some of the firm's payments for a brief period.[154] But the New Bankruptcy Law has no provisions that regulate this kind of payment.[155] Given that a firm in reorganization is clouded by previous bad business operation, bankruptcy judges tend to limit the trustee's compensation at the beginning of a reorganization case.[156] According to Article 5 of the "Provisions of the Supreme People's Court on the Decision of Administrators' Compensation during the Trial of Enterprise Bankruptcy Cases" (Provisions of Administrator Compensation), the amount of compensation cannot be changed unless a creditor's meeting rejects it.[157] The meager compensation is problematic when trustees

152. *See* Zuì gâo rén mín fa yuàn guân yú shěn li qi yè pò chan àn jiàn zhi ding guan l? rén de guî ding (最高人民法院关于审理企业破产案件指定管理人的规定) [Provisions of the Supreme People's Court on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases (China)] art. 20 (adopted by the Supreme People's Court, Apr. 4, 2007, effective June 1, 2007), *available at* http://www.chinacourt.org/flwk/show.php?file_id=117759.

153. *See* Jiang Xinye, *supra* note 25, at 78; *see also* You Bingning, *supra* note 142, at 35.

154. *See* You Bingning, *supra* note 142, at 34.

155. *Id.*

156. *Id.*

157. *See* Zuì gâo rén mín fa yuàn guân yú shěn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding (最高人民法院关于审理企业破产案件确定管理人报酬的规定) [Provisions of the Supreme People's Court on the Decision of Administrators' Compensation during the Trial of Enterprise Bankruptcy Cases]

pay for the firm's expenses out of their own pockets. Sometimes, when reorganization fails, the firm cannot afford to compensate the trustee.[158] Even if trustees employ Article 12 of Provisions of Administrator Compensation and terminate the reorganization procedure, trustees may still be left empty-handed.[159]

But the major deterrent to participation is the unpredictable legal liability. Although the New Bankruptcy Law has enumerated "duties" for trustees,[160] the sloppily drafted catchall provision deters many professionals from practicing. Section 9 of Article 25 states that bankruptcy trustees shall perform "any other functions and duties that the people's court believes it should perform."[161] The many different interpretations of this provision invite chaos. Some judges have gone so far as to conclude that this puts a duty on the trustee to find placement for the firm's former employees.[162] To add to the confusion, the New Bankruptcy Law, which adopts fiduciary duty from U.S. corporate law, provides that a bankruptcy trustee shall be diligent and dutiful, and shall faithfully perform its duties as well.[163] This vague provision causes problems for the judiciary. If a bankruptcy court reads Article 27 too broadly, then any bad decision will open the trustee to liability. Coincidently, China's new corporate law of 2005 also introduced context-specific fiduciary duties in one simple and sloppily drafted provision that has already drawn a lot of attention from academia.[164] Unlike corporate management, bankruptcy professionals are not able to walk away easily from the chaos unless not applying for trustee candidacy.

(China)] art. 5 (adopted by the Supreme People's Court, Apr. 4, 2007, effective June 1, 2007), *available at* http://www.chinacourt.org/flwk/show1.php?file_id=117758.

158. *See* You Bingning, *supra* note 142, at 34.

159. *See* Zuì gâo rén mín fa yuàn guân yú shĕn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding (最高人民法院关于审理企业破产案件确定管理人报酬的规定) [Provisions of the Supreme People's Court on the Decision of Administrators' Compensation during the Trial of Enterprise Bankruptcy Cases] (China)] art. 12 (adopted by the Supreme People's Court, Apr. 4, 2007, effective June 1, 2007), *available at* http://www.chinacourt.org/flwk/show1.php?file_id=117758.

160. In the New Bankruptcy Law, art. 25 reads:

> A bankruptcy administrator shall perform the following functions and duties:
> (1) Taking over the assets, seals as well as the account books and documents of the debtor;
> (2) Investigating into the financial status of the debtor and formulating the financial statements;
> (3) Deciding the internal management of the debtor;
> (4) Deciding the daily expenditure and other necessary expenditures of the debtor;
> (5) Deciding, before the first creditors' meeting is held, to continue or suspend the debtor's business;
> (6) Managing and disposing of the debtors' assets;
> (7) Participating actions, arbitrations or any other legal procedures on behalf of the debtor;
> (8) Proposing to hold creditors' meetings; and
> (9) Performing any other functions and duties that the people's court believes it should perform.

In the case of any separate provision on the bankruptcy administrator's functions and duties in the present Law, it shall prevail. *See id.* art. 25.

161. *Id.*

162. *See, e.g.*, You Bingning, *supra* note 142, at 35; *see also* Yang Jian, *supra* note 135, at 291.

163. *See* Zhông huá rén mín gòng hè guo qi yé po chan fa, (中华人民共和国企业破产法) [Law on Enterprise Bankruptcy (China)] art. 27 (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *available at* http://www.gov.cn/flfg/2006-08/28/content_371296.htm.

164. *See* Weng, *supra* note 100, 138-40.

Similarly, creditors are dissatisfied with the vagueness of trustee liability. The unclear trustee fiduciary duty provisions limit private enforcement.[165] When creditors look to the New Bankruptcy Law for a legal remedy, they find the enumerated "duties" in Article 25 ambiguous and unhelpful in differentiating between duty and function.[166] For instance, Section 4 of Article 25 states that a trustee shall decide "the daily expenditure and other necessary expenditures of the debtor."[167] This section defines the trustee's function rather than the trustee's duty. If this is a functional definition rather than a standard of conduct, plaintiffs cannot employ it to sue the trustee. The only provision that can be identified as a duty is in Article 27. Contrary to the trustees' concerns, the interest groups are concerned with what happens if the bankruptcy court narrowly applies the provision. Considering how difficult it is to litigate successfully, interested parties will not feel safe handing the firm over to a trustee who will not be held culpable for negligent or self-benefitting acts.

In sum, high practice risk and unpredictable private enforcement issues are the root causes of the reorganization trustees' dilemmas. Tackling these two issues is the linchpin in solving these dilemmas. It is obvious that the two issues share the same problem of incompleteness that stems from the current trustee fiduciary duty legislation. Therefore, the best solution is to revise the trustee liability provisions in the New Bankruptcy Law. The trustee fiduciary duty mechanism and its externalities can properly tackle the above problems and help encourage trustees to apply for candidacy.

V. The Solution: Second Time Transplantation

The reorganization trustee mechanism has been developing for over seventy years since the promulgation of the Chandler Act of 1938.[168] The past lessons and successes of this reorganization trustee vehicle have helped to shape an effective and neutral management method for insolvent firms. Although the trustee fiduciary duty mechanism is not perfect in the United States, as discussed in the first and second sections of this Article, it is much more complete than China's New Bankruptcy Law Article 27.

If the mechanism that is transplanted from foreign law is called into question, there are two factors we should review: the difference of application environment and the completeness of transplantation. Trustee fiduciary duty in reorganization is highly context-specific and technical. It is specially devised for unique reorganization cases. Reorganization is a carefully and deliberately designed institution used to resolve business failures rather than indigenous cultural failures. Therefore, when discussing the applicability of a foreign country's reorganization institution, it is necessary to reduce the impact of domestic culture to a minimum. If this presumption stands, the solution to improving China's trustee fiduciary duty in reorganization dilemmas will be obvious and simple: China must retro-

165. *See* Ma Cunli & Su Jie, *Pò chan guan li rén chéng xìn yì wù yán jiû jí qí duì wo guó pò chan lì fa de qi shì* (破产管理人诚信义务研究及其对我国破产立法的启示) [Research of Bankruptcy Trustees' Fiduciary Duty and Its Inspiration to Chinese Bankruptcy Legislation], 7 ZHONGGUO SHANG FA NIAN KAN [CHINESE COMMERCIAL LAW ANNUAL REVIEW] 443, 450 (2007).

166. You Bingning, *supra* note 142, at 34.

167. *Id.*

168. *See* DAVID A. SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 113-134 (Princeton Univ. Press 2001).

spect the completeness of the former transplantation. The conclusion of such retrospect is undisputable, judging from the meager provisions.[169] It is highly possible that the legislature did not thoroughly examine all of the U.S. case law and scholarly literature on trustee fiduciary duty in reorganization. The result is a huge vacuum area of trustee fiduciary duty in reorganization after the bankruptcy legislation.[170] Based on the U.S. case law and scholarly literature, a complete and logical trustee fiduciary duty mechanism can be erected. As analyzed earlier, the tailored corporate fiduciary duty will be a reasonable solution under reorganization trustee context.

Introducing tailored corporate fiduciary duties to the New Bankruptcy Law would provide a better guideline for incumbent trustees, potential trustee candidacy applicants, and interested parties. A clearer legal framework brings better predictability. By increasing the predictability of the trustees' liability, trustees' practice risk will be lower, encouraging better-trained professionals to apply for trustee candidacy. Solving this major problem will greatly ameliorate the dilemmas trustees face, although more compensation and designation-related legislative actions are imperative in the future.[171]

VI. Beyond the Solution

A. Are You Prepared?

In 2006, there were only 4,253 bankruptcy cases in China.[172] No official data has been released regarding the number of reorganization cases. We do know that China has significantly fewer bankruptcy cases than the United States; one can assume that this is the

169. *See* Zhông huá rén mín gòng hè guo qi yé po chan fa, (中华人民共和国企业破产法) [Law on Enterprise Bankruptcy (China)] art. 25, 27 (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *available at* http://www.gov.cn/flfg/2006-08/28/content_371296.htm; Zuì gâo rén mín fa yuàn guân yú shěn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding (最高人民法院关于审理企业破产案件确定管理人报酬的规定) [Provisions of the Supreme People's Court on the Decision of Administrators' Compensation during the Trial of Enterprise Bankruptcy Cases] (China)] art. 12 (adopted by the Supreme People's Court, Apr. 4, 2007, effective June 1, 2007), *available at* http://www.chinacourt.org/flwk/show1.php?file_id=117758; *see also* You Binging, *supra* note 142, at 34-35; Yang Jian, *supra* note 135, at 291; Weng, *supra* note 100, 138-40.

170. *See* Zhông huá rén mín gòng hè guo qi yé po chan fa, (中华人民共和国企业破产法) [Law on Enterprise Bankruptcy (China)] arts. 25, 27 (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), *available at* http://www.gov.cn/flfg/2006-08/28/content_371296.htm; Zuì gâo rén mín fa yuàn guân yú shěn li qi yè pò chan àn jiàn què ding guan li rén bào chóu de guî ding (最高人民法院关于审理企业破产案件确定管理人报酬的规定) [Provisions of the Supreme People's Court on the Decision of Administrators' Compensation during the Trial of Enterprise Bankruptcy Cases] (China)] art. 12 (adopted by the Supreme People's Court, Apr. 4, 2007, effective June 1, 2007), *available at* http://www.chinacourt.org/flwk/show1.php?file_id=117758; *see also* You Binging, *supra* note 142, at 34-35; Yang Jian, *supra* note 135, at 291; Weng, *supra* note 100, 138-40.

171. The trustees' liability issue is the most prominent problem and needs to be tackled first. To focus discussions on the trustees' liability issue, other causes of trustees' dilemmas will not be discussed in this article.

172. *See* Gao Shangmin, *Guân yú shěn li qi yè pò chan àn jiàn zhi ding guan li rén de guî ding de lí jiě yu shì yòng* (关于审理企业破产案件指定管理人的规定的理解与适用) [The Understanding & Application of the Provisions on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases], 5 Ren Min Si Fa [People Justice] 23, 24 (2007) (China).

same for reorganization cases.[173] With so few reorganization cases, is the revision of the trustee fiduciary duty necessary? It is probably not important in the short run, but it is certainly important in the long run. The result of the following macroeconomic analysis will demonstrate the necessity of the revision and explain the answers.

Since China pegged the value of the Yuan to the U.S. dollar to keep its exporters competitive amid falling demand due to the global recession at the beginning of 2008, Chinese currency has been under pressure due to the appreciation imposed by the United States.[174] Although "G-20 leaders [recently] declined to endorse a U.S. push to pressure China to allow the Yuan to rise,"[175] the Chinese Yuan has still appreciated by twenty-one percent since July 2005.[176] The State Council of China conducted a pressure test in the first quarter of 2010 to study the relationship between appreciation limitation and export.[177] The results showed that three to five percent of additional appreciation would eradicate all profitability of manufacture-oriented exports.[178] But since the pressure test, the Yuan has already appreciated by three percent.[179] Facing low profitability, many export-orientated enterprises stopped business expansion.[180] Capital that was earmarked for production has instead been invested in the real estate market, which is considered the safest and most lucrative investment,[181] resulting in the inflation of a real estate bubble. This should be a warning sign to the Chinese economy.[182] Some bubble pre-burst signs have already been noticed by economic analysts.[183] If the real estate bubble were to burst, many enterprise investors would have to seek bankruptcy protection.

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173. The Fee Information and Collection System (FICS) contains data on 131,089 Chapter 11 filings between Jan. 1, 1989 and Dec. 31, 1995. The Administrative Office of the United States Courts (AOUSC) data shows 129,304 Chapter 11 cases for the same period, excluding filings from Alabama and North Carolina. Even if any number is divided by 6, the number of U.S. reorganization cases is far bigger than China's bankruptcy cases in total. *See* GORDON BERMANT & ED FLYNN, U.S. DEP'T OF JUSTICE, BANKRUPTCY BY THE NUMBERS 1, http://www.justice.gov/ust/eo/public_affairs/articles/docs/abi98febnumbers.pdf.

174. *China-US Talks: China Vows More Currency Reform*, BBC NEWS, May 24, 2010, http://www.bbc.co.uk/news/10143745.

175. Matthew Bristow, *'Currency War' Continues, Mantega Says as Summit Ends*, BLOOMBERG, Nov. 12, 2010, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aKjB7yyZo.4I.

176. Wang Yong, *Avoiding a US-China Currency War: Need for Rational Calculation*, EAST ASIA FORUM, Apr. 11, 2010, http://www.eastasiaforum.org/2010/04/11/avoiding-a-us-china-currency-war-need-for-rational-calculation/.

177. *Duô bù mén chóng qi rén mín bì yâ lì cè shì* (多部门重启人民币压力测试) [Multiple Departments Reactivate RMB Pressure Test], IFENG, Mar. 18, 2010, http://finance.ifeng.com/forex/rmb/20100318/1940756.shtml (China).

178. *Id.*

179. *Id.*

180. *Chû k?u jiâ gông xíng qi yè de zhuan xíng wèn tí* (出口加工型企业的转型问题) [The Transformation Issue of Export-Orientated Manufacturer], WTOJOB, Oct. 10, 2007, http://class.wtojob.com/class95_22761.shtml (China).

181. Gu Chun, *Fáng dì chan lì rùn lái de tài róng yì* (房地产：利润来的太容易) [Real Estate: Easy Profits], CREI NETWORK, http://www.crei.cn/files/20109/2010f9d17c1311141726.html (last visited May 14, 2011) (China).

182. Steven Mufson, *In China, Fear of a Real Estate Bubble*, WASH. POST, Jan. 11, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/01/10/AR2010011002767.html.

183. *Fáng dì chan pào mò jiân rù gâo wçi qî* (房地产泡沫渐入高危期) [Real Estate Bubble Has Been into Dangerous Stage], SINA REAL ESTATE NETWORK, July 7, 2010, http://news.dichan.sina.com.cn/2010/07/07/181781.html (China).

Export-oriented enterprises are still capable of making a profit so long as they can absorb the currency influence.[184] If they have successfully entered into a reorganization procedure by then, many such enterprises could still keep their last hope to reverse their firms' decline. Such a situation would lead to a boom in bankruptcy practice, similar to what happened in the United States in the late 1980s.[185] With hundreds of thousands of export-oriented enterprises engaging actively in China's real estate market now, a burst in the real estate bubble would create the need for many qualified trustees to resurrect their businesses.

Therefore, given the high odds of a real estate bubble burst, trustee fiduciary legislation is actually a pressing issue. If China is lucky enough to weather the currency war and avoid a real estate bubble, a sound trustee fiduciary duty mechanism probably would not be needed immediately. But if China cannot weather the crises, ex ante consideration and evaluation are always the sagacious legislative strategy.

B. SOLUTION'S SOLUTION: LEGISLATION PLUS A BRAND NEW METHOD—CASE DIRECTIVE

Although we have already discussed possible solutions to complete China's trustee fiduciary duty mechanism of the New Bankruptcy Law, there is still an essential issue that needs resolution given the different legal traditions between the United States and China. Great care must be given when transplanting case law statutes to a civil law country.[186] First, the legislature should clarify whether Article 27 governs trustees' functions or duties to prevent further confusion. Second, current problematic provisions should be replaced by more specific trustee fiduciary duty provisions to overcome the shortcoming of oversimplified and sloppily drafted provisions. The improved provisions should explicitly differentiate between a trustee's duty of care and duty of loyalty. Third, the New Bankruptcy Law should set the standard of review for the duty of care to the business judgment rule. Last but not least, trustee immunity should be articulated to avoid vagueness.

In bankruptcy, where there is legislation, of course, there will be efforts to circumvent it.[187] This is absolutely true in the fiduciary duty context. Given that the duty is a context-specific one, it is impossible for the legislature to exhaust all possible application scenarios. In adjudication, there will be legal gaps left for judges to fill. Although in the past decades China's legal reform achievements have been stunning,[188] it is not a wise choice to

184. *See, e.g.*, ANDREW B. ABEL ET AL., MACROECONOMICS 498-501 (7th ed. 2010).

185. Skeel, *supra* note 168, at 221-23.

186. China falls within the family of continental law countries, also known as civil law countries, where the main source of law is statutes and where judicial precedents have hardly any binding effect. *See* SHEN ZONGLIN & BIJIAO FA YANJIU, 比較法研究 [RESEARCH ON COMPARATIVE LAW] 142 (1998).

187. Skeel, *supra* note 168, at 121.

188. *See, e.g.*, Xia Jinwen, *Dâng dài zhông guó sî f? gžì gé chéng jiù wèn tí yu chû lù yi rén mín fa yuàn wéi zhông xîn de fçn xî* (当代中国司法改革：成就，问题与出路-以人民法院为中心的分析) [Contemporary China's Legal Reform: Achievements, Problems & Solutions-Focus on People's Court], 1 ZHONGGUO FA XUE [CHINA L. SCIENCE] 17 (2010).

leave excessive discretionary powers to an asymmetrically developing judiciary.[189] This legislation gap would invite inefficiency and corruption of the judiciary.[190] But recourse of flexibility and certainty is out of the capability of *lex scripta*. A new adjudication method is currently being tested and developed in China's corporate courts.

Admittedly, case law is more efficient than statutes in reacting to the rapid changes in the business world. In 2005, the Supreme Court of China mandated high courts to compile a "Case Directive" and distribute it to the lower courts to unify adjudication standards.[191] This task is primarily undertaken by research departments of local high courts and intermediary courts.[192] The departments compile and publish periodical cases uploaded to an intranet by adjudication departments.[193] Courts embrace publications from the higher courts, as they set very important parameters used to evaluate lower courts' judges' work with the "Double R Rate," which is the remand and reverse rate.[194] By following these cases, the Double R Rate significantly dropped.[195] Additionally, if a case from a higher court is obviously unsuitable due to social changes, lower court judges tend to rule inconsistently to reflect such social changes. Usually, some of these cases will be selected and compiled as well for higher court reference.[196] Although following precedent is not stipulated by law, it is already a common adjudication practice in the Chinese judiciary.[197] Given the challenge of the recent economic reforms, most of the cases compiled are focused on business disputes.[198] Although there are still disputes about whether this is a trend towards de facto case law,[199] it will greatly alleviate the inflexibility of statute law. The optimal way to fill possible statutory gaps regarding trustee fiduciary duty in reorganizations will be to periodically and specially compile the Case Directive with trustees' duty cases. Organized legislation, supplemented by the Case Directive on trustees' fiduciary duty, is the most comprehensive and viable solution to implementing the second adaptation of trustee duty. After tackling the trustee liability issue, China's judiciary will be better prepared for the potential wave of future bankruptcies.

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189. *See, e.g.*, Xiao Yang, *Zhông guó sî f? g?i gé de chéng jî y? fâ zh?n qû shì* (中国司法改革的成绩与发展趋势) [The Achievements & Developing Tendency of Contemporary China's Legal Reform], 13 REN MIN SI FA [PEOPLE JUSTICE] 4 (2007); *see also* Xia Jinwen, *supra* note 188, at 17.

190. *See* Weng, *supra* note 100, at 140.

191. Rén mín fa yuàn dì èr gè wu nián g?i gé gâng yào (2004–2008) (人民法院第二个五年改革纲要 (2004–2008)) [The Second Five Year Reform Platform (2004–2008) (China)] (promulgated by the Sup. People's Ct., Oct. 26, 2005), *available at* http://www.dffy.com////.htm.

192. Interview with anonymous judges at Zhejiang High Court & Shanghai Fist Intermediary Court (Nov. 22, 2010).

193. *Id.*

194. *Id.*; *see, e.g.*, Weng, *supra* note 100, at 135-36 (discussing how the evaluation effects judges).

195. Interview, *supra* note 192.

196. Rén mín fa yuàn dì èr gè wu nián gai gé gâng yào (2004–2008) (人民法院第二个五年改革纲要 (2004–2008)) [The Second Five Year Reform Platform (2004–2008) (China)] (promulgated by the Sup. People's Ct., Oct. 26, 2005), *available at* http://www.dffy.com////.htm.

197. *See* Hu Yunteng & Yu Tongzhi, *Àn lì zhi dao zhì dù ruò gân zhòng dà yí nán zhçng yì wèn tí yán jiû* (案例指导制度若干重大疑难争议问题研究) [Researches of Case Directive Major & Controversial Issues], 6 FA XUE YAN JIU [LEGAL STUDY] 3 (2008).

198. *See* Interview, *supra* note 192.

199. *See* Hu Yunteng & Yu Tongzhi, *supra* note 197, at 3.